Karya Lagenda Sdn Bhd v Kejuruteraan Bintai Kindenko Sdn Bhd & Anor

COURT OF APPEAL (PUTRAJAYA) — CIVIL APPEAL NO W-02–1184 OF 2005
GOPAL SRI RAM, ZULKEFLI AND RAUS SHARIF JJCA
16 JULY 2007

Contract — Building contract — Performance bond — Bond given by sub-contractor to main contractor to guarantee performance of sub-contract works — Whether on demand or conditional bond — Whether mere demand from main contractor sufficient to make demand on bond — Whether demand must state basis of claim against sub-contractor

The appellant (the first defendant in the High Court) was the sub-contractor engaged by the second defendant (the first respondent in this appeal) for a development project. At the request of the first defendant, the plaintiff bank (the second respondent in this appeal) issued a Banker's Guarantee in favour of the second defendant. This was required in the building contract between the first defendant and the second defendant. Disputes arose between the first and second defendant in the performance of the building contract. The second defendant made a demand on the bank guarantee. The first defendant challenged the validity of the demand. No payment was made to the second defendant by the plaintiff bank. The first defendant then demanded from the plaintiff bank the release of the fixed deposit funds utilized as security for the bank guarantee. The plaintiff bank did not accede to this demand. Interpleader proceedings were commenced in the High Court by the plaintiff bank. The main question before the court was whether the second defendant's demand was valid to trigger payment of the bank guarantee. The High Court ordered that judgment be entered against the plaintiff in favour of the second defendant and the first defendant's counterclaim be dismissed. The first defendant appealed to the Court of Appeal.

Held, dismissing appellant's appeal:

(1) The bank guarantee is a performance bond. Whether a performance bond is conditional or unconditional must depend on the terms of the bond itself (see para 9).

(2) The bank guarantee is an unconditional and 'on demand' bank guarantee. Payment should therefore be effected by the plaintiff notwithstanding any contestation by the first defendant or the plaintiff when a valid demand is made by the second defendant (see para 10).

(3) Since the bank guarantee is a unconditional and 'on demand' bank guarantee, there is no necessity for the demand letter as contended by the first defendant to expressly assert that the first defendant had failed to perform or breached the underlying building contract (see para 11).

(4) The bank guarantee is a distinct legal document from the building contract, which is an agreement between the first defendant and second defendant. The building contract forms no part of the bank guarantee. All that is required to activate it is a written demand by the second defendant (see para 13).

[Bahasa Malaysia summary

Perayu (defendan pertama di Mahkamah Tinggi) adalah subkontraktor yang diupah oleh defendan kedua (responden pertama dalam rayuan ini) untuk satu projek pembangunan. Atas permintaan defendan pertama, bank plaintif (responden kedua dalam rayuan ini) mengeluarkan Jaminan Bank kepada defendan kedua. Ini adalah keperluan dalam kontrak binaan antara defendan pertama dan defendan kedua. Pertikaian timbul antara defendan pertama dan kedua dalam melaksanakan kontrak binaan. Defendan kedua membuat tuntutan ke atas jaminan bank. Defendan pertama mencabar keesahan tuntutan tersebut. Tiada pembayaran dibuat kepada defendan kedua oleh bank plaintif. Kemudian, defendan pertama menuntut kepada bank plaintif untuk mengeluarkan tabung deposit tetap yang digunakan untuk menjamin jaminan bank. Bank plaintif tidak memenuhi permintaan ini. Prosiding interplider telah dimulakan di Mahkamah Tinggi oleh bank plaintif. Persoalan utama di hadapan mahkamah sama ada permintaan defendan kedua adalah sah untuk melepaskan pembayaran jaminan bank. Mahkamah Tinggi memerintahkan penghakiman dimasukkan terhadap plaintif bagi pihak defendan kedua dan tuntutan balas defendan pertama ditolak. Defendan pertama merayu kepada Mahkamah Rayuan.

Diputuskan, menolak rayuan perayu:

(1) Jaminan bank adalah bon perlaksanaan. Sama ada bon perlaksanaan adalah bersyarat atau tidak bersyarat hendaklah bergantung kepada terma-terma bon itu sendiri (lihat perenggan 9).

(2) Jaminan bank adalah tidak bersyarat dan jamian bank 'atas permintaan'. Bayaran oleh itu hendaklah dibuat oleh plaintif walaupun terdapat pertikaian oleh defendan pertama atau plaintif bila tuntutan sah dibuat oleh defendan kedua (lihat perenggan 10).

(3) Memandangkan jaminan bank adalah tidak bersyarat dan jaminan bank 'atas permintaan', tiada keperluan untuk surat tuntutan sebagaimana ditegaskan oleh defendan pertama bagi penegasan dengan jelas bahawa defendan pertama telah gagal melaksanakan atau melanggar dasar-dasar kontrak binaan (lihat perenggan 11).

(4) Jaminan bank adalah dokumen perundangan yang berbeza dengan kontrak binaan, yang merupakan perjanjian antara defendan pertama dan defendan kedua. Kontrak binaan tidak membentuk sebahagian daripada jaminan bank. Apa yang diperlukan adalah untuk mengaktifkannya sebagai tuntutan bertulis oleh defendan kedua (lihat perenggan 13).]

Notes

For cases on performance bond, see 3(2) *Mallal's Digest* (4th Ed, 2006 Reissue) paras 2883–2888.

Cases referred to

Cygal Bhd v Bandar Subang Sdn Bhd [2004] 3 CLJ 67 (refd)

HSH Engineering & Construction v Belton Properties Sdn Bhd [2001] 2 CLJ 186 (refd)

Hermis Interco BV Sdn Bhd v Syarikat Pembinaan Hashnudin Sdn Bhd [1986] 1 MLJ 245 (refd)

LEC Contractors (M) Sdn Bhd (formerly known as Lotteworld Engineering & Construction Sdn Bhd) v Castle Inn Sdn Bhd & Anor [2000] 3 MLJ 339 (refd)

Syarikat Perumahan Pegawai Kerajaan Sdn Bhd v Bank Bumiputra Malaysia Bhd [1991] 2 MLJ 565 (refd)

Teknik Cekap Sdn Bhd v Public Bank Berhad [1995] 3 MLJ 449 (refd)

Appeal from: Originating Summons No D5–24–165 of 2005 (High Court, Kuala Lumpur)

Chen Mian Kuang (MK Chen & Leong) for the appellant.

Rodney Gomez (Shearn Delamore & Co) for the first respondent.

K Ganesan (Satrinder Kaur with him) (Muhammad Ganesan & Nazri) for the second respondent.

Raus Sharif JCA (delivering judgment of the court):

[1] This is an appeal by the first defendant against the judgment of the High Court, Kuala Lumpur, ordering in an interpleader proceedings, a judgment be entered against the plaintiff in favour of the second defendant for the sum RM2,075,700.94 with costs to be borne by the first defendant.

[2] The facts of this case are these. The second defendant was the main contractor for Sri Rampai project ('the project'). The first respondent was the sub-contractor engaged by the second defendant for the project. At the request of the first defendant the plaintiff issued a Bankers Guarantee No TF001G784990 dated 27 June 2003 ('bank guarantee') for the sum of RM2,075,700.94 in favour of the second defendant. The bank guarantee was arranged for by the first defendant as required in the building contract between the first and second defendant.

[3] Disputes arose between the first and second defendant in the performance of the building contract. The second defendant alleged that the works were not completed on time by the first defendant as stipulated in the building contract even after an extension of time was granted by the second defendant.

[4] Subsequently, the second defendant made a demand on the bank guarantee. The first defendant challenged the validity of the demand. Hence, no payment was made to the second defendant by the plaintiff. The first defendant than demanded for the released of the fixed deposit funds, secured for the granting of the bank guarantee. The plaintiff did not accede to the same.

[5] On 13 May 2005, the plaintiff commenced an interpleader proceeding in the High Court to determine the question whether, inter alia, there is liability to pay on the bank guarantee. The first defendant in turn made a counterclaim against the plaintiff for the released of the first defendant's fixed deposit funds. On 24 October 2005, the High Court decided in favour of the second defendant. The first defendant's counterclaim was accordingly dismissed. Hence, this appeal.

[6] The main question before the High Court as well as before this court was whether the second defendant's demand was valid to trigger payment of the bank guarantee. The issue as to the release of the fixed deposit funds would hinge on the outcome of the main question. If the plaintiff did not have to pay out of the bank guarantee, the plaintiff has to release the fixed deposit funds to the first defendant.

[7] It is the first defendant's case that the second defendant's demand was invalid. The reasons were:

(i) it failed to clearly and expressly assert that the first defendant had failed to perform or breached the underlying building contract;

(ii) by the time the second defendant made the demand, the building contract has been mutually terminated and there can therefore be no breach of contract to trigger payment under the bank guarantee;

(iii) the second defendant had failed to present the original bank guarantee to the plaintiff together with its demand.

[8] The second defendant responded by stating:

(i) the bank guarantee is an unconditional and 'on demand' bank guarantee. Payment therefore must be effected by the plaintiff when a valid demand on the bank guarantee is made;

(ii) there was no mutual determination of the building contract. There were discussion and negotiations entered into between the first defendant and second defendant, but the same was unsuccessful. Even if there was a mutual agreement (which was strongly denied by the second defendant) the first defendant is still not absolved of its liability under the bank guarantee.

(iii) The bank guarantee make no reference or requirement that the original bank guarantee must be produced at the time of the demand before payment can be made.

Whether the bank guarantee conditional or unconditional

[9] The learned High Court Judge ruled that the bank guarantee dated 27 June 2003 issued by the plaintiff in favour of the second defendant is an unconditional guarantee or 'on demand bond' and all that is required to activate it is a written demand by the second defendant. The learned High Court Judge rejected the argument of the necessity for the second defendant to prove default on the part of the first defendant in performance of the building contract. We are in agreement with the learned High Court Judge. It is our judgment that the bank guarantee is a

performance bond. Whether a performance bond is conditional or unconditional must depend on the terms of the bond itself (*Teknik Cekap Sdn Bhd v Public Bank Berhad* [1995] 3 MLJ 449). In the present case, the relevant clause of the bank guarantee read as follows:

> If the contractor, unless relieved from the performance by any clause of the contract or by statute or by the decision of a tribunal of competence jurisdiction, *shall in any respect fail to perform under the contract or commit any breach of his obligation there under, then the guarantor shall pay to the principal* up to a total aggregate sum not exceeding the amount of RINGGIT MALAYSIA TWO MILLION SEVENTY FIVE THOUSAND SEVEN HUNDRED AND SEN NINETY FOUR ONLY (RM2,075,700.94) *on the principal's demand notwithstanding any contestation of protest by the contractor or by the guarantor or by any third party,* provided always that the total of all partial demands so made shall not exceed the aggregate sum of RINGGIT MALAYSIA TWO MILLION SEVENTY FIVE THOUSAND SEVEN HUNDRED AND SEN NINETY FOUR ONLY (RM2,075,700.94) and the guarantor's liability to pay the principal as aforesaid shall correspondingly be reduced proportionate to any partial demand having been made as aforesaid.' (emphasis added)

[10] It is our judgment the above clause is a clear indication that the bank guarantee is an unconditional and 'on demand' bank guarantee. Payment should therefore be effected by the plaintiff notwithstanding any contestation by the first defendant or the plaintiff when a valid demand is made by the second defendant. In this case there is no dispute that several demands were made by the second defendant, claiming from the plaintiff for the full some of the bank guarantee amounting to RM2,075,700.94 due to non performance of the building contract.

[11] We are of the view, since the bank guarantee being a unconditional and 'on demand' bank guarantee there is no necessity for the demand letter as contended by the first defendant to expressly assert that the first defendant had failed to perform or breached the underlying building contract. Hence, the High Court Judge's finding on this issue is not erroneous.

[12] In fact the wordings of the bank guarantee in the present case is identical to the wordings of performance bond/bank guarantee that have come before the courts (see *Syarikat Perumahan Pegawai Kerajaan Sdn Bhd v Bank Bumiputra Malaysia Bhd* [1991] 2 MLJ 565; *Cygal Bhd v Bandar Subang Sdn Bhd* [2004] 3 CLJ 67; *Hermis Interco BV Sdn Bhd v Syarikat Pembinaan Hashnudin Sdn Bhd* [1986] 1 MLJ 245; *HSH Engineering & Construction v Belton Properties Sdn Bhd* [2001] 2 CLJ 186 and *LEC Contractors (M) Sdn Bhd (formerly known as Lotteworld Engineering & Construction Sdn Bhd) v Castle Inn Sdn Bhd & Anor* [2000] 3 MLJ 339). In all these cases the courts have consistently held that such guarantee/bond is an 'unconditional bond' or an 'on demand bond'. We have no reasons to interpret differently.

Mutual determination of the contract

[13] The learned High Court Judge agreed with the second defendant that although there were discussions and negotiations between the first and second defendant there was no mutual determination of the building contract. He also ruled

that even if there was a mutual determination of the building contract, first defendant is still not absolved of the liability of the bank guarantee. Again, we are in agreement with the learned High Court Judge. There was no mutual determination of the building contract. In any event, it is our judgment that the bank guarantee to which the plaintiff and second defendant are a party to, is distinct legal document from the building contract, which is an agreement between the first defendant and second defendant. The building contract forms no part of the bank guarantee. The bank guarantee by its terms as stated earlier is unconditional and a pure on-demand guarantee. All that is required to activate it is a written demand by the second defendant.

Failure to present the original bank guarantee at the time of demand

[14] It is our judgment this issue has no bearing in the present case. The payment mechanism as contained in the bank guarantee make no reference or requirement that the original bank guarantee must be produced at the time of demand before payment can be made. It is not a contractual requirement which must be complied with in this case. To us this is a non-issue.

[15] For the above reasons, we unanimously dismissed the appeal and the usual orders consequential on dismissal were made.

Appeal dismissed.

Reported by Brendan Navin Siva